Direct Investing Is a Marathon, Not a Sprint

Once family offices build out their deal-sourcing capabilities, they need to shift emphasis to expanding operational components.

*This is **part three** of a four-part series on the powerful new role that family offices are playing in private equity.*

Sourcing opportunities and winning deals are, of course, vital pieces of any direct investment strategy. But family offices should understand that getting the deal done is only the first step. The heavy lifting happens in the weeks, months, and years after the deal closes.

Yet, many family offices underestimate the importance of monitoring their direct investments on a continuing basis. They focus their energies on sourcing the deal and getting it done. Then, they open the champagne and move on when they should be rolling up their sleeves and plotting a strategy to make the deal succeed in the long run.

“Most of the accidents in direct investing happen because the family office has taken its eye off the ball and isn’t properly monitoring its portfolio,” says Francois de Visscher, founder of de Visscher and Co. LLC, an independent financial advisor to single-family offices.

He notes that family offices typically operate with a lengthier holding period compared to a traditional private equity investor. So, whether they pay 6 times or 6.5 times EBITDA for a particular business doesn’t make a whole lot of difference. “The purchase price is never really the issue,” de Visscher says. “Where family offices trip up is when they don’t spend enough time with an investment or when they don’t have the resources to properly monitor that business.”

Family offices are an increasingly formidable presence in the private equity universe and much of their success is attributed to the fact that they have done a great job of building up their deal sourcing capabilities and partnering with professionals who have significant experience in making deals.

But, going forward, this may not be enough. The people who are really moving the needle in today’s PE industry are not only the deal makers but the operating partners—the professionals who sit down with the management team on a regular basis to discuss strategy and address the challenges of the business. They make key contributions in areas from executive compensation to acquisition opportunities.

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“The deal making sophistication of family offices is growing stronger by the day,” says Jeremy Swan, Managing Principal—Financial Sponsors & Financial Services Industry Practice at CohnReznick. “But when it comes to the post-transaction operations of these businesses, they have not built out those capabilities to the same extent. Direct investing is an ongoing journey for family offices and portfolio monitoring is clearly the next step on that journey.”

In many ways, long-term portfolio monitoring is more important for family offices than for traditional financial sponsors. Why? Traditional sponsors are under pressure from their LPs to put money to work quickly and get a rapid return on investment whereas family offices can operate at a more measured pace. Family offices are not under the gun to constantly deploy capital. Their goal is to grow their investments year over year as a way to compound their wealth.

The question then is: How can family offices best monitor their direct investments and work with management to grow value over the long term? Can they handle that task in-house or should they turn to an outside network of advisors to help them manage their portfolios?

The answer depends on how much direct investing the family office does. If a family office does an abundance of deals every year then, by all means, they should consider hiring a full-time staff to monitor those investments.

If, on the other hand, a family office makes only one or two investments per year, that may not be enough activity to justify maintaining a full-time staff to manage the portfolio. In this case, it probably makes more sense to partner with trusted advisors who are intimately familiar with operating issues and can help monitor those few deals.

"Family offices are starting to embrace this virtual model," says Swan. "They may have one or two people on staff for deal sourcing and then have a team of outside advisors working on everything from governance and operational issues to value creation and cybersecurity. With this virtual model approach, family offices can build out the necessary operating skills and really fill the talent gap."

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It's also important for family offices to keep in mind that, as a practice, monitoring can be shaped differently depending on what the family wants to accomplish with its portfolio. For instance, one family office may look at direct investing as an efficient vehicle for compounding wealth. Another office may be making investments as a way to provide employment opportunities for future generations.

"The way you monitor your investments will depend on your objectives," says de Visscher. "If your goal is to open up opportunities for family members, you will want to work with management to groom family members to serve as the next generation of executives in the business. But, if your strategy is pure wealth-building, that's very different. Maybe you are not looking for an exit but, if you see the right offer, you may pursue it. Then, there has to be constant communication and a strong alignment of interests between the management team and the family office."

Whatever their investment goals, it's vital for family offices to keep in mind that portfolios, like families themselves, do best when given the care and attention they need.

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